No. 21,642

IN THE

United States Court of Appeals

For the Ninth Circuit

SONORA COMMUNITY HOSPITAL,
a California corporation,
Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPELLANT'S OPENING BRIEF

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INTRODUCTION

For purposes of this brief the appellant, Sonora Community Hospital, a California corporation, will be referred to as appellant; the respondent, Commissioner of Internal Revenue, will be referred to as respondent; Sonora Hospital Laboratory and X-ray Company will be referred to as Laboratory and X-ray; Ben R. Boice, M.D. will be referred to as Dr. Boice; Paul L. Anspach, M.D. will be referred to as Dr. Anspach; Helen Anspach, M.D. will be referred to as Dr. Helen, and Jack Rucker and James C. Rucker will be referred to as the Rucker Bros.

This action originated in the Tax Court of the United States and is an action on behalf of the ap-

pellant, a corporation organized pursuant to the General Non-profit Corporation Law, Part 1 of Division 2 of Title 1 of the Corporations Code of the State of California. Appellant owned and operated at all times in question a 42 bed general hospital in the City of Sonora, County of Tuolumne, State of California, and within the territorial jurisdiction of the United States Court of Appeals for the Ninth Circuit. The income tax returns for the years in question were filed with the District Director of Internal Revenue in San Francisco, California. (Int. Rev. Code Section 7482.)

STATEMENT OF THE CASE

Appellant was organized as a non-profit corporation on March 21, 1958 and on or about March 31, 1958 appellant acquired all of the assets of the Sonora Community Hospital and since said date has owned and operated the said general hospital facility.

The fiscal year of appellant was April 1, of each year to March 31, of the following year. Appellant filed a Return of Organization Exempt from Income Tax (Form 990-A) for each of the fiscal years ending March 31, 1959, March 31, 1960, and March 31, 1961. (Findings of Fact p. 2; Stip. of Fact No. 1.)

On February 29, 1960, the respondent ruled that appellant was exempt as an organization described in Section 501(c)(3) of the Internal Revenue Code of 1954 on the basis that appellant had shown that it was organized and operated exclusively for charitable pur-

poses. This ruling was made effective beginning April 1, 1958. (Findings of Fact p. 13; Stip. of Fact No. 4.)

On December 26, 1962, the respondent revoked the ruling of February 29, 1960. (Findings of Fact p. 13; Stip. of Fact No. 5.)

The computation of the tax due under the decision of the Tax Court in this action has been computed and stipulated to by the parties. (Tax Court Decision dated Sept. 19, 1966.)

Therefore, the sole question is whether appellant was exempt from tax as a corporation "organized and operated exclusively for . . . charitable . . . purposes, . . . no part of the net earnings of which inures to the benefit of any private . . . individual. . . ." (T. C. Opinion p. 14.)

The Internal Revenue Code of 1954, Section 501 (c)(3) reads as follows:

> Sec 501. Exemption from Tax on Corporations, Certain Trusts, Etc.
>
> (a) Exemption From Taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.
>
> * * * * * * *
>
> (c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):
>
> * * * * * * *
>
> (3) Corporations, and any community chest, fund, or foundation, organized and operated ex-

clusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, . . .

SPECIFICATION OF ERRORS

I. IT WAS ERROR FOR THE TAX COURT TO HOLD THAT THE APPELLANT'S TAX EXEMPT STATUS WAS AFFECTED BY THE DOCTOR'S RECEIPT OF INCOME FROM THE SONORA HOSPITAL LABORATORY AND X-RAY COMPANY.

The respondent's only contention that a part of the net earnings of appellant inured to the benefit of a private individual concerns the payments made from the Sonora Hospital Laboratory and X-ray Company to Dr. Boice and Dr. Anspach. These payments were made during part of the time to a business entity of Dr. Boice and Dr. Anspach, known as Leasing Company of Sonora; however, no difference in the taxability of appellant would result thereby and appellant agrees that such payment can be considered as being made directly to the doctors. For tax purposes all payments made to the Leasing Company of Sonora by the Laboratory and X-ray were considered as personal income to the doctors. (Stip. of Fact No. 19.)

Appellant contends that income received by the Laboratory and X-ray was income of a completely separate business entity and in no way can be considered

income of the appellant, and for that reason, no part of such income can be considered as the net earnings of appellant which inured to the benefit of the doctors.

On the bottom of page 16 of the Tax Court's Opinion, a statement is made that "It is no answer to say that the gross receipts of these facilities were paid to the Rucker Bros. and were technically never part of the hospital's income." (T.C. Opinion p. 16.) Appellant contends exactly the opposite in that if the gross receipts of the Laboratory and X-ray were not part of appellant's income, then any payments from them could not affect in any way appellant's tax exempt status.

The agreement by the Rucker Bros. and Dr. Boice and Dr. Anspach providing for the payment of one-third of the receipts of the Laboratory and X-ray was made on January 9, 1956 and was to run for ten years from that date. The agreement therefore preceded the incorporation of appellant and extended by its terms to a time subsequent to the fiscal years here in question. The agreement was not changed, affected or modified by the incorporation of appellant and it was not until September 25, 1961 that appellant purchased all the business assets and good-will of the Laboratory and X-ray from the Rucker Bros. and thereby terminated any further obligations under the January 9, 1956 contract. (Stip. of Fact No. 18.)

The Laboratory and X-ray were operated as a completely separate business entity by the Rucker Bros. (Findings of Fact p. 5; Stip. of Facts Nos. 6, 9 and 12; Tr. pp. 170-172.)

The Laboratory and X-ray billed and collected for all services rendered to "out-patients" and appellant billed and collected for all services rendered by the Laboratory and X-ray to "in-patients" and remitted all such collections to the Laboratory and X-ray. (Stip. of Fact No. 9.)

The Laboratory and X-ray maintained its own set of books, filed its own tax returns, employed its own personnel and maintained its own bank accounts. (Tr. p. 47.)

This being the case, regardless of the reasons or amounts of money paid out to Dr. Boice and Dr. Anspach, these funds do not represent net earnings of the appellant inuring to the benefit of private individuals. The fact that part of the gross earnings of the Laboratory and X-ray was paid out to someone other than the owner of the Laboratory and X-ray is immaterial as far as the tax exempt status of the appellant is concerned.

The gross receipts of the Laboratory and X-ray are stipulated to and appear on page 18 of the Findings of Fact. All these amounts were included, not as earnings of appellant, but as gross earnings of the Laboratory and X-ray which was never exempt from income taxes and it could thereby distribute those earnings to whomever it pleased and in particular, to Dr. Boice and Dr. Anspach under the January 9, 1956 agreement.

A question may arise as to the reason for the operation of the Laboratory and X-ray as a separate

business entity. The answer can be found in Section 362 and 363 of the California Administrative Code that requires general hospitals in California to contain an X-ray department and a clinical laboratory. (See Appendix A, attached hereto.) Dr. Boice, in his testimony, advised that there was not money available to provide the Laboratory and X-ray for appellant; that appellant was borrowed to its fullest extent and that it was therefore necessary for the Rucker Bros. to continue the ownership and operation of the Laboratory and X-ray to provide the needed equipment, supplies and staff. (Tr. p. 46.)

In retrospect, it may be that when appellant was first organized, it would have been economically advantageous for it to have provided its own laboratory and X-ray facility as it eventually did, upon the purchase from the Rucker Bros. on September 25, 1961; however, appellant contends that it is neither desirable or necessary that the Tax Court or the Appellate Court pass judgment on this kind of an administrative decision long after the decision has been made. The fact is that appellant was financially unable to provide the required Laboratory and X-ray facilities and therefore arrangements with the Rucker Bros. acting as a separate business entity were continued. (Tr. p. 46.)

Appellant introduced testimony to show that Dr. Boice and Dr. Anspach, because of personal services rendered to the Laboratory and X-ray, would have been justified in receiving the amounts paid to them even if the Laboratory and X-ray had been owned

and operated by the appellant and the earnings therefrom were appellant's earnings.

It is customary for Laboratory and X-ray departments to pay approximately twenty-five to fifty percent of their gross receipts for professional services rendered to them by the responsible licensed director. (Tr. pp. 39-42, 180, 183 and 184.)

The Tax Court's answer to the contention that the founding doctors should receive compensation for their services was that the doctors supervising the Laboratory and X-ray departments did not have any special qualifications as pathologists or radiologists and they did not actively operate or supervise the Laboratory. (Tr. pp. 8-11, 17 and 18.)

As the Tax Court noted, California Business and Professions Code Sections 1284 and 1285 (Appendix B) required the Laboratory to have the services of a licensed clinical Laboratory bioanalyst or a licensed physician and surgeon to provide direct and responsible supervision to the Laboratory. (Tr. pp. 78, 79, 169.) It should be noted that these Sections do not require a pathologist. The owners of the Laboratory were neither physicians or bioanalysts and thus were not qualified to be directors. (Tr. p. 169.) The hospital was also required to have a professional person supervising the X-ray department. (Tr. p. 44.) Therefore, the founding doctors and one of the employees of the doctors, a Dr. Howard, performed these services for the Laboratory and the X-ray units and Dr. Boice and Dr. Howard were actually licensed with

the state as the supervisors of the Laboratory. (Tr. pp. 76-83, 178.)

The services were both of a formal and active nature. Dr. Boice, and beginning in 1959 Dr. Howard, signed all documents requiring the signature of the director of the Laboratory. (Tr. pp. 76-83, 178.) The doctors examined X-rays, did fluoroscopy work, examined blood count reports and other laboratory analyses and reports. (Tr. pp. 41, 42.) They actually read X-rays for other doctors as a radiologist would and performed the duties of a radiologist with respect to the X-ray unit. (Tr. pp. 74, 99, 107 and 108.) Also, their work as directors of the Laboratory was not substantially different from what a pathologist-director would do. (Tr. pp. 42, 100, 101 and 105.) Even though as far as the license for the laboratory was concerned, Drs. Boice and Howard were the directors during the years in question, as far as practice was concerned, Dr. Anspach was a co-director. (Tr. p. 85.)

In May, 1960, when the hospital hired a qualified radiologist, the owners of the Laboratory and X-ray were instructed by the doctors to pay the entire one-third of the gross receipts to the hospital rather than to the founding doctors. (Tr. pp. 47 and 48.) This was done despite the fact that the radiologist took over only the X-ray unit supervision. (Tr. pp. 47 and 48.) The radiologist subsequently hired by the appellant received thirty per cent of the gross receipts after his first two or three months. (Tr. p. 48.)

Appellant contends that the Tax Court erred in its Finding to the contrary and in particular its Finding on page 9 that "Neither Dr. Boice nor Dr. Anspach rendered compensable services in the X-ray department as director or otherwise . . ." and on page 10 of the Findings generally to the effect that none of the doctors did any more than "that of any physician who might have sent his patients to the laboratory for tests . . ."; however, appellant strongly urges that these adverse findings are in reality irrelevant to the main issue as to whether the money paid to the doctors by the Laboratory and X-ray were earnings of the appellant.

The facts are clear and uncontroverted as to the derivation of the money paid to the doctors and these facts just cannot be ignored or construed to give them the character and substance of appellant's earnings.

Some point has been made of other benefits received by Dr. Boice and Dr. Anspach, such as providing a hospital facility for their own patients or in that the appellant was providing space to the Laboratory and X-ray which benefited the doctors; however, the doctors contributed approximately $250,000.00 to $275,000.00 in the form of the hospital building, land, and equipment in exchange for promissory notes on which they never attempted collection of interest or principal. (T.C. pp. 6, 7; Tr. pp. 29, 30, 33, 51-56; Findings of Fact 13.)

In addition, Dr. Boice, Dr. Anspach and Dr. Helen, shared all administrative responsibilities of the appellant from 1957 through the years in question with-

out compensation. (Tr. pp. 50-53, 56, 114; Findings of Fact pp. 11 and 12.)

It seems clear that any such benefits have been offset many times over by the services and the assets provided to the appellant without charge by the doctors.

It should be kept in mind that the organization was just getting started at the time of the tax years in question and taking all dealings into consideration there can be no doubt that the doctors were neither attempting nor were actually making a profit from their dealings with the appellant.

The case at bar is similar in many respects to *Olney, et al. v. Commissioner,* 17 T.C.M. 982. In that case, Dr. Olney had his own office in the hospital and occupied three rooms. He moved in on December 15, 1952 and it was not until 1954 that it was decided that he should pay rent for the past two years of use. In addition, the charges of both the doctor and hospital were entered on the same patient card and only one bill was sent to the patient for both services. Receipts representing payments for both the hospital's and the doctor's charges were deposited in their joint account. The operating expenses of both the doctor and the hospital were paid from this same account and the same set of books were used for the first two years. Despite this complete commingling and intertwined relationship, the Tax Court held that the hospital was tax-exempt.

Even if it is assumed arguendo that the doctors in the case at bar did not deserve one-third of the gross

receipts for their services, there can be no doubt that their overall dealings with the appellant, taking into consideration their administrative services and the assets they contributed, were more praiseworthy and less subject to criticism than the dealings of Dr. Olney with his hospital in the *Olney* case.

In contrast to the case at bar is the situation in *Kenner et al. v. Commissioner,* 20 T.C.M. 185 (affirmed 318 F. 2d 632 (1963) wherein the Tax Court denied the petitioner exempt status, and rightfully so. In *Kenner* between 1944 and 1950, over $230,000 of the hospital's funds went for the payment of expenses of farms owned by the founder and for his personal living expenses. Between 1950 and 1954, about $290,000 of the hospital's funds were used for Arizona real estate and other ventures of the founder. The doctor also listed the hospital as one of his personal assets when applying for loans. In addition, there was an indiscriminate commingling of funds in bank accounts arising from fees and charges for medical services made by the hospital and founder alike.

The *Kenner* case is an example of where the net earnings of the hospital were definitely inuring to the benefit of an individual in contrast to the case at bar where the founding doctors lost money in assisting the fledgling hospital to get a start.

It is appellant's position that a careful and accurate determination made on the basis of the stipulated facts and the Tax Court's Findings of Fact and following the above reasoning must conclude that it was error for the Tax Court to hold that the appellant's

tax exempt status was affected by the doctor's receipt of income from the Sonora Hospital Laboratory and X-ray Company.

II. IT WAS ERROR FOR THE TAX COURT TO HOLD THAT THE APPELLANT WAS NOT OPERATED EXCLUSIVELY FOR CHARITABLE PURPOSES.

It is the position of the appellant, that a hospital could be granted the exemption under Section 501 (c) (3), even if it did not render any free service to patients. This is true, because the very nature of a hospital is to render service to those individuals who are sick or injured and in need of medical care. As long as the hospital is not operated for the personal gain of any individual it appears that charges may be made to cover the costs of the hospital operation and the hospital still be considered a "charitable" organization.

This is in line with the rule that the exemption of charities is to be liberally construed. (G. C. M. 21610, 1939-2 Cum. Bull. 103.)

It is interesting to notice some of the definitions of the word "charity" taken from Black's Law Dictionary (Fourth Edition 1951). They are as follows:

1. Accomplishment of some social interest.
2. Advancement of purposes beneficial to public.
3. All which aids man and seeks to improve his condition.
4. Amelioration of persons in unfortunate circumstances.

5. Improvement of man.

6. Improvement of spiritual, mental, social and physical conditions.

7. Physical, mental or moral betterment.

8. Relief of persons in unfortunate circumstances.

The regulations under the Internal Revenue Code of 1954 state that, "The term 'charity' is used in section 501 (c) (3) in its generally accepted legal sense, and is, therefore, not to be construed as limited by the separate enumeration in section 501 (c) (3) of other tax-exempt purposes which may fall within the broad outlines of 'charity' as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged, . . ." (Regulation Section 1.501 (c) (3) (2).)

It is evident from the above definitions that the word "charity" means much more than the providing of free services or materials. It appears more that purpose of the organization or effort is paramount. In the case of a hospital the primary and major purpose is to provide medical treatment to the sick and injured. This certainly can be construed as "relief to the distressed" or the "amelioration of persons in unfortunate circumstances" or the "improvement or betterment of physical conditions."

It is emphasized that in this context whether or not the services are provided free of charge is of little consequence just so the organization is not

operated or motivated for the benefit or enrichment of private interests.

This is recognized by the respondent in Revenue Ruling 56-185, C. B. 1956-1, 202 which is set forth as Appendix C.

An analysis and comparison will be made of each of the requirements of the stated Revenue Ruling with the facts in this case:

1. Paragraph 1 of the ruling requires that the hospital must be organized as a nonprofit charitable organization for the purpose of operating a hospital for the care of the sick.

The Findings of Fact on page 6 and page 2 of the Tax Court Opinion and Stipulated Facts 1, 2, 3 and 10 clearly indicate that the appellant was so established.

2. The sentences of paragraph 2 of the ruling will be discussed individually.

a. It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay.

Appellant was in its first three years of operation, during the time in question, indebted to the lending agency for the funds used in the construction of the building and to Dr. Boice and Dr. Anspach on the notes executed in their favor for their equity interest in the former proprietary partnership hospital. Patronage and operating results were at best conjectural in the new hospital facilities. Appellant had no endowment and no source of income other than the fees received for services rendered to patients. (Findings of Fact p. 12.)

Under these circumstances, appellant's financial ability to provide free services was very limited, but the appellant did admit and retain charity patients in a very small number of instances. In some instances patients were admitted with the understanding that they would pay less than the full regular charges—usually to the extent that hospital insurance or some other similar plan covered the services rendered. (Findings of Fact p. 12.)

The type of charity services provided by appellant is very significant. If a patient could pay nothing and was eligible for County Hospital care, the patient was generally referred to the County Hospital. (Findings of Fact p. 12; Tr. pp. 58-68 and pp. 115-118.) If a patient had low paying insurance benefits or owned property or was in other ways ineligible for County Hospital care, then appellant accepted the patients on the basis of receiving partial payment. (Findings of Fact p. 12; Tr. pp. 58-68 and pp. 115-118.)

By this arrangement appellant was performing the greatest possible community service. The very poor were eligible for medical care from the County Hospital facility; those able to pay could provide for their own private hospitalization, but the patient who was neither eligible for County Hospital care nor able to pay the entire cost of private care was assisted by appellant. Truly, appellant was providing charity to the extent of its financial ability to a segment of the community who would otherwise be without medical care or find it difficult to obtain. Thus,

appellant was meeting a serious community need in its granting of charity. By this arrangement the greatest number of patients were given medical care—the indigent and eligible at the County Hospital, and those neither eligible nor able to fully pay at the hospital operated by appellant.

b. It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay.

Because appellant had no endowment and no source of income other than fees, it was necessary to control in some the amount of free care provided. In this situation any free care provided must be recovered from charges made to paying patients. Appellant therefore was required to limit free care to the extent of its financial ability. It therefore charged those able to pay and at no time ever refused admission to a charity patient in an emergency. (Findings of Fact p. 12; Tr. pp. 117 and 118.) It is evident appellant did not deny medical care to those unable to pay. It either accepted them as emergency charity patients, part pay patients or referred them to the County Hospital where they could obtain medical care.

c. The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability.

The Tax Court and the respondent have made a point that the amount of charity provided by appellant is not sufficient to be counted. Under the circumstances of appellant's beginning operations in a new and heavily encumbered facility with no endow-

ment or other income funds, one can reasonably expect the amount of free care to be small. Dr. Boice did state that the amount of free care furnished was less than one per cent. (Findings of Fact p. 12; Tr. p. 60.) Let us assume that the free care and part pay care was equal to one per cent of the business. That would be $3,982.49 for the fiscal year ending March 31, 1959 (Exhibit 1-a); $3,665.81 for the fiscal year ending March 31, 1960 (Exhibit 2-b); and $3,524.65 for the fiscal year ending March 31, 1961. Considering that for each one of these fiscal years the taxable income, as revised in the stipulated computation of tax liability, which is a part of the Tax Court decision, was $49,781.34 for 1959; $15,216.75 for 1960 and $12,709.82 for 1961, the amount of charity thus computed is not disproportionate to the financial ability of appellant. It is strongly urged that in view of the recent origin of appellant and its heavy capital indebtedness that these amounts of charity are adequate to meet the intent of the Revenue Ruling and Revenue Code. Additional evidence of the amount of charity provided can be obtained from the Exemption Application filed by appellant on August 21, 1959. (Form 1023; Exhibit 4-d.) That document shows on page 2 that during the last complete year appellant had 12,081 full pay patient days; 340 part pay patient days and 113 charity patient days. It is noted that the free patient days approximate one per cent of the full pay patient days and there are additional part pay patient days. In addition the record book admitted into evidence as appellant's exhibit

numbers 20 and 21 show the number of part pay patient days and charity patient days for the period of April 1959 through September 1959. Other similar records for other periods had been lost.

d. It may furnish services at reduced rates which are below cost, and thereby render charity in that manner.

Without repeating all that has been stated previously, this provision in the Revenue Rulings appears to exactly conform to the type of charity being rendered most frequently by appellant.

e. It may also set aside earnings which it uses for improvements and additions to hospital facilities.

During the years in question the appellant was heavily mortgaged for its construction costs and earnings were required to pay the mortgage payments, provide new equipment and establish operating reserves. (Tr. p. 28.)

f. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such service.

Of course, this requirement must be read in connection with the rest of the ruling. The admission of charity patients must be limited to financial ability. Appellant conformed to the reasonable requirements of this sentence by accepting charity patients in emergencies; arranging for transfer or admission to the County Hospital where eligible and providing for some free and part pay patients as its financial ability allowed.

g. **Furthermore, if it operates with the expectation of full payment from all those to whom it renders service, it does not dispense charity merely because some of its patients fail to pay for the services rendered.**

Appellant has not used any of the write-off of bad debts as a part of its recognized charity. Only the free or part pay patients who arranged for charity prior to admission have been included. (Findings of Fact p. 12; Tr. pp. 58, 59, 90, 91, 115-119.) In addition to the charity granted prior to admission, appellant wrote off as bad debts accounts receivable in the amount of $14,559.21 in fiscal 1959; $12,226.00 in fiscal 1960 and $15,082.08 in fiscal 1961. (Respondent's stipulated computation statement attached to the Tax Court Decision.)

There is an implication that the fact appellant turned over unpaid patient accounts, including the portion that part pay patients agreed to pay to a collection agency for the purpose of collection is inconsistent with the operation of a tax-exempt hospital. Since the write-off of bad debts doesn't count to any degree for charity and since the ability to provide charity depends exclusively on the income produced by paying patients, it seems that to neglect to follow through with collection procedures against patients able to pay would tend to reduce the charitable capability of a tax-exempt hospital and could be construed as allowing net income to inure to the benefit of individuals, namely, the non-paying but able to pay patients. For these reasons, it is urged that any such implication be rejected. A tax-exempt hospital must be able to enforce payment from those

able to pay. Any other result would be completely unreasonable, and would render the facility inoperative especially where the only source of income is from fees charged.

3. It must not restrict the use of its facilities to a particular group of physicians and surgeons, such as a medical partnership or association, to the exclusion of all other qualified doctors.

Appellant has always operated with an "open" medical staff. At the time appellant acquired the hospital ten doctors were in Sonora, seven were on the medical staff, four of those were in the medical group. At the time of trial (January, 1966) there were about fifteen doctors in Sonora, eleven of whom were on the medical staff and five of those were in the medical group.

4. Its net earning must not inure directly or indirectly to the benefit of any private shareholder or individual.

This provision goes to one of the main issues in this case and is discussed at length elsewhere in this brief. Appellant contends that none of its net earnings have inured directly or indirectly to the benefit of any private individual. The Tax Court in *Olney et al. v. Commissioner,* 17 T. C. M. 982, held that the petitioner hospital was operated "exclusively" for charitable purposes. The evidence indicated that $55,000.00 worth of free service was rendered over a five-year period to 200 in-patients. Services worth $25,000.00 were rendered to out-patients. It appears during the five years of charity that the hospital's gross income was over $250.000.00 per year. However,

the Court stated in a footnote that the record did not show the number of patients who received entirely free treatment, nor did it show the per cent of the total charge paid by the patient who paid only a portion of the charge. The Court also stated, "In most cases the patient's ability to pay was determined after the services had been performed." Therefore, it appears that much of the "charity" was really uncollectible debts.

In the case at bar, it does not appear that appellant's charity record was substantially different than the hospital in *Olney*.

Taking into consideration the fact that some of the "charity" in *Olney* was evidently uncollectible accounts and the charity in the case at bar was agreed to in advance (Tr. p. 58), there is little difference between the charity records in *Olney* and the case at bar. Also, there was no evidence of any absolutely free services in *Olney,* whatsoever. The Court in deciding *Olney* cited *Commissioner v. Battle Creek,* 126 F. 2d 405 (1942) for the proposition that "So long as admission and treatment to the hospital in question are not denied to those unable to pay, an institution is classed as charitable." Patients were never refused emergency care by appellant, whether they could pay or not. (Tr. p. 117.) Admittedly, some patients seeking admission were referred to the county hospital, while others considered deserving were either given free care or reduced-rate care. (Tr. pp. 57, 58, 115-117.)

This practice of referring some to county hospital should not be considered "denying treatment to those

unable to pay," for it is common knowledge that most tax exempt hospitals follow this practice, and render relatively small amounts of free services and it is respectfully requested that the Honorable Court take judicial notice of these facts.

The matter of which a Court will take judicial notice must be a subject of common and general knowledge. *Waters-Pierce Oil Co. v. Deselins,* 212 U.S. 159 (1905). Those matters familiarly known to the majority of mankind are properly within the concept of judicial notice. *Leach v. Burr,* 188 U.S. 510 (1902).

It is also common knowledge that usually the only place to receive free hospital care is in a County Hospital and this fact also should be judicially noticed. During each of the three years in question, either no-pay or part-pay patients were admitted. (Tr. pp. 114-119).

Mr. Floyd Moses, the business manager of appellant testified as to the charity rendered to patients during the period in question on the direction of the hospital administrator. He testified as to the record books where entries of such charity were made. (Tr. pp. 141-157). Actual examples of appellant's charity were presented by Mr. Leo Laramy who testified as to the care that was furnished him by the appellant without charge and also the free care that was furnished a patient by the name of Mrs. Hershurt. (Tr. pp. 127-134).

Based upon the above stated facts and the reasonable interpretation of those facts, it is strongly urged that the Court determine that it was error for the Tax

Court to hold that the appellant was not operated exclusively for charitable purposes.

CONCLUSION

The Tax Court in its opinion on page 16 refuses to specify any of the points raised by respondent as "the crucial factors" and even declines to rule whether the arrangement with the Rucker Bros. is a diversion of appellant's income, and then states that in the aggregate the considerations establish that appellant is not operated exclusively for charitable purposes.

If not one of the factors involved in this proceeding would render appellant ineligible to receive tax-exempt status, then it is contended that a multiplication of innocent factors can in no way be accumulated to produce a finding of ineligibility for tax-exempt status.

Why could not the Tax Court single out any one consideration or factor and why couldn't it precisely rule concerning the payments from the Laboratory and X-ray to the doctors? There is only one answer. None of the single factors or considerations nor the arrangement with the Rucker Bros. would establish appellant's non-charitable purpose.

This is not a difficult or complicated case. Only two questions are raised. The first has to do with the payment from the Laboratory and X-ray to Dr. Boice and Dr. Anspach. The answer is simple. The appellant hospital required an X-ray department and a clinical laboratory. It had no funds to equip and operate its

own and the Rucker Bros. continued to own and operate the two facilities as a separate entity. Their income had nothing to do with the hospital income. Payment of their own income to Dr. Boice and Dr. Anspach can in nowise be construed to be a diversion of appellant's earnings. The uncontroverted testimony of Dr. Boise and Dr. Anspach affirms that no payments of any kind were ever made to them by appellant, not even for their administrative services or on the obligation originally due them. They forgave the obligation and performed the administrative services free. Therefore, no part of the net earnings of appellant inured to the benefit of any private shareholder or individual.

The second question concerns the charitable operation of appellant. Having analyzed respondent's own Revenue Ruling sentence by sentence, the conclusion seems clear. Appellant was organized and did operate exclusively for charitable purposes within the intent of Internal Revenue Code Section 501 (c) (3).

This writer is a member of the Board of Directors of four tax-exempt hospitals. Appellant's operations with regard to free care is not dissimilar to any other presently tax-exempt hospital in the writer's knowledge. As a matter of fact, with the advent of Medicare and Medi-Cal there is virtually no free medical care to be provided. It is virtually all paid under some government sponsored social program or by private and group insurance.

There is an ironic twist to this present action. Appellant's tax-exempt status has now been reinstated

effective after the reorganization of 1961. Any final tax imposed will therefore necessarily have to be paid from assets now held by a tax-exempt hospital and not from any assets that have allegedly been improperly diverted.

For all of the foregoing reasons it is respectfully urged that the decision of the Tax Court be reversed and that a decision be made holding that for the years in question appellant was organized and operated as a tax-exempt charitable organization within the provision of Internal Revenue Code Section 501 (c) (3) and that the revocation of the exempt status be annulled.

Dated, San Jose, California,
February 21, 1968.

Very respectfully yours,
ANDERSON AND MORGAN,
By ALVIN L. ANDERSON,
Attorneys for Appellant.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ALVIN L. ANDERSON

(Appendices A, B and C Follow.)

Appendices A, B and C

Appendix A

CALIFORNIA ADMINISTRATIVE CODE

362. Radiology. (a) General hospitals and tuberculosis hospitals shall maintain a radiology department with diagnostic and fluoroscopic facilities. Shielding and space to assure safe handling of patients and protection of personnel while taking films shall be provided.

(b) General hospitals of 100 beds or more shall maintain facilities for deep and superficial therapy. This may not be required if it can be demonstrated to the department that such facilities are available in the community.

(c) Tuberculosis nursing homes shall provide a fluoroscope if pneumothorax or pneumoperitoneum is done in the institution. Diagnostic X-ray facilities shall be readily accessible in the community.

363. Laboratory. Laboratories shall be operated in conformance with California Business and Professions Code, Division 2, Chapter 3, Sections 1200 to 1322, and California Administrative Code, Title 17, Chapter 2, Subchapter 1, Group 2, Sections 1030 to 1050.

(a) General hospitals of less than 100 beds, and tuberculosis hospitals and sanatoria shall maintain a laboratory for emergency laboratory work, such as urinalysis, complete blood counts, hemoglobin, blood typing, cross matching, and other necessary work in the community. If reasonable laboratory facilities are not readily available, the hospital shall be staffed and

equipped to carry out all laboratory procedures, except in rare and unusual circumstances where other facilities or personnel may be required.

(b) General hospitals of 100 beds or more shall maintain laboratory facilities and equipment for chemical, bacteriological, seriological, pathological, and hematological services. All laboratory procedures shall be done in the hospital, except in rare and unusual circumstances where other facilities or personnel may be required.

Appendix B

CALIFORNIA BUSINESS AND PROFESSIONS CODE

1284. It is unlawful for any person to conduct, maintain, or operate a clinical laboratory unless such clinical laboratory is under the direct and responsible supervision and direction of one of the following:

(a) A licensed clinical laboratory bioanalyst.

(b) A physician and surgeon licensed under the chapter on medicine of this code.

1285. It is unlawful for a licensed clinical laboratory bioanalyst or physician and surgeon to serve only as the nominal director or supervisor of a clinical laboratory.

Appendix C

REV. RULING 185, 1956-1 CUM. BULL. 203

In order for a hospital to establish that it is exempt as a public charitable organization within the contemplation of section 501(c) (3), it must, among other things, show that it meets the following general requirements:

1. It must be organized as a nonprofit charitable organization for the purpose of operating a hospital for the care of the sick. A nonprofit hospital chartered only in general terms as a charitable corporation can meet the test as being organized exclusively for charitable purposes. See Commissioner v. Battle Creek, Inc. 126 F.2d 405.

2. It must be operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay. It is normal for hospitals to charge those able to pay for services rendered in order to meet the operating expenses of the institution, without denying medical care or treatment to others unable to pay. The fact that its charity record is relatively low is not conclusive that a hospital is not operated for charitable purposes to the full extent of its financial ability. It may furnish services at reduced rates which are below cost, and thereby render charity in that manner. It may also set aside earnings which it uses for improvements and additions to hospital facilities. It must not, however, refuse to accept patients in need of hospital care who cannot pay for such services. Furthermore, if it operates with the expectation of full payment from all those to whom it renders services, it does not dispense

charity merely because some of its patients fail to pay for the services rendered.

3. It must not restrict the use of its facilities to a particular group of physicians and surgeons, such as a medical partnership or association, to the exclusion of all other qualified doctors. Such limitation on the use of hospital facilities is inconsistent with the public service concept inherent in section 501 (c) (3) and the prohibition against the inurement of benefits to private shareholders or individuals. It is recognized, however, that in the operation of a hospital there must of necessity be some discretionary authority in the management to approve the qualifications of those applying for the use of the medical facilities. The size and nature of facilities may also make it necessary to impose limitations on the extent to which they may be made available to all reputable and competent physicians in the area.

4. Its net earnings must not inure directly or indirectly to the benefit of any private shareholder or individual. This includes the use by or benefit to its members of its earnings by way of a distribution of profits, the payment of excessive rents or excessive salaries, or the use of its facilities to serve their private interests. If provision is made in the bylaws for dividends, exemption will not be allowed even though no dividends have been declared. Exemption will not be defeated, however, merely because the shareholders or members might possibly at some future date share in the assets upon dissolution in the absence of a case of mala fides where there appears to be a plan on the part of the shareholder or individual to acquire assets on the dissolution of the corporation.